20 December 2017

NZ Data Galore

- Current account deficit small and getting smaller
- But may start to edge higher later in 2018
- Exports and imports both very strong in November
- Surely growth supportive
- Dairy prices dip on growing world milk supply
- We nudge our 2018/19 milk price forecast lower
- Net migration steady in November; tourism growth continues

There was a dump of NZ data this morning, covering the current account deficit for Q3, and merchandise trade, net migration, and tourism in November. It is a lot of information following on from this morning's dairy auction.

Overall, there was nothing to shake the idea that the economy continues to expand at a reasonable clip. However, there are more signs of dairy prices easing that will be a drag on exports in 2018.

The current account deficit for the year to September came in at the equivalent of 2.6% of GDP. This matched our expectations, although the deficit was marginally bigger than market expectations of 2.5%. The annual deficit continues to shrink (it was 2.8% of GDP in the year to June) and remains small by NZ's historical standards. The current account deficit remains off the market's radar at present. We think the annual deficit will remain low near term, before starting to widen later in 2018.

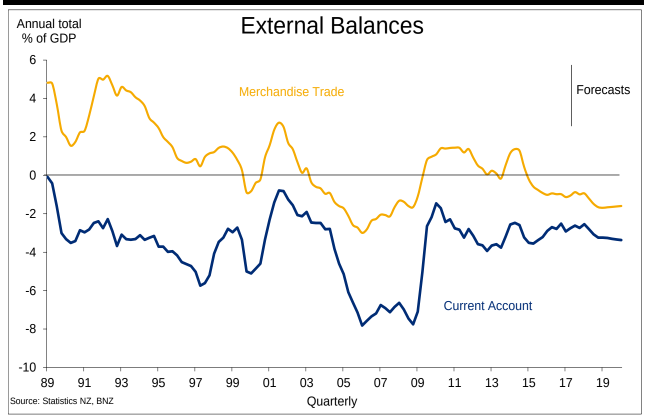
More immediately, the current account figures offer support to our calculations for tomorrow's GDP report via lifting our expenditure measure of GDP higher. It is not enough to alter our formal estimate for Q3 GDP growth that remains at 0.7%, but it helps our comfort levels of our estimate being a touch above market expectations.

November's merchandise trade deficit was $1,193m, much wider than market (and our) expectations driven by much stronger imports. Imports were 26.7% higher than a year ago. The import surprise was not only due to nearly $300m worth of aircraft imports, but also significant strength elsewhere across capital, intermediate, and consumption goods. We take this as a positive signal for demand and economic activity, at least in the first instance. This is in contrast to the mildly negative NZD reaction, which we presume was mostly related to the bigger than expected monthly trade deficit rather than the other data released at the same time. However, while import growth is indicative of strong demand or at least expectations of strong demand, it is important to note that we have detected some signs of bigger than usual inventory build appearing in the final quarter of the year through the likes of the PMI and PSI surveys. This suggests some vulnerability if expectations of final demand were to disappoint.

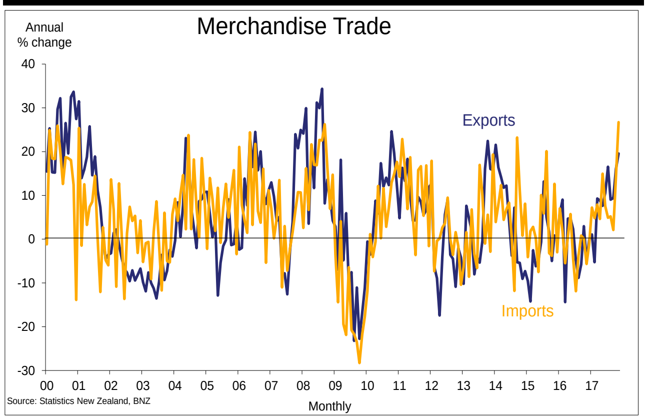
November's exports were a whopping 19.6% higher than a year ago. While extremely strong, and driven by primary products like logs (+50%), meat (+47%) and dairy (+22%), it was close to expectations. We remain of the view that the currently very strong annual export growth will peak in the final quarter of 2017 and slow in 2018. Lower dairy prices are part of this view.

There was certainly no Christmas cheer for farmers in the auction overnight. Prices fell across the board, with the overall GDT Price Index sliding 3.9%. Following a reprieve

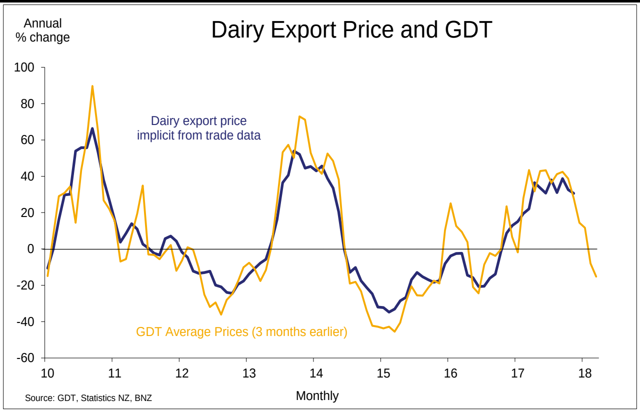
Currently Shrinking



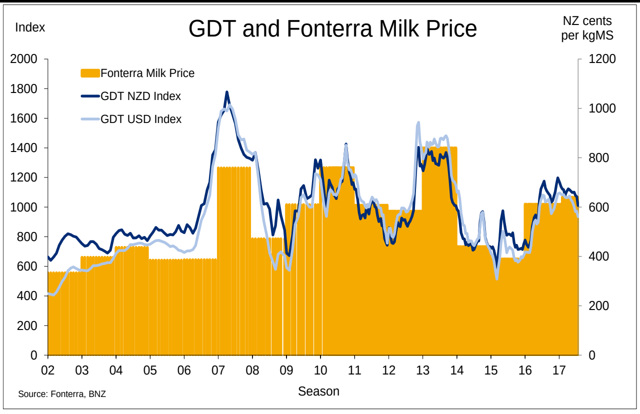
November Trade Strong



Export Headwind Developing



Downward Pressure On Fonterra's Milk Price



at the previous early-December auction, global dairy prices have reverted to their previous downtrend. Prices are down a cumulative 13% from their recent peak in September to also be down 13% on a year ago. These lower prices will weigh on export returns in the first half of 2018.

It also maintains downside risk to our $6.30 forecast for Fonterra's milk price in the 2017/18 season. Fonterra has recently trimmed its own view to $6.40 from $6.75. Indeed, as we have noted previously, if it weren't for the current dry weather risk to NZ milk production we would be nudging our forecast lower. This season's milk price may end lower anyway given some recent isolated pockets of rain and the possibility that world prices are now less sensitive to NZ weather conditions (with EU production no longer bound by quotas). This would not be a good development for NZ, as it would mean that during NZ dry periods the economic hit from lower production would see less offset from higher prices as has tended to be the case in the past.

We think dairy prices are falling due to increasing global milk supply, aided by still very low international grain prices. Conditions in the EU are very important. Strong EU milk production, a still very large EU stockpile of SMP, and possible changes to the EU's intervention program are expected to keep prices under downward pressure in 2018. So too exports of SMP from Canada following a prior change to domestic pricing methods.

We already forecast a lower NZ milk price for the 2018/19 season, on expected higher global milk supply. Obviously there are many factors that can alter the outlook for that season, including currency fluctuations. But on current trends in global milk production, we nudge our 2018/19 forecast down to $5.70 from $6.00 previously.

The other data released this morning revealed a net migrant inflow of 5,610 in November on a seasonally adjusted basis. This was similar to October's result. While still a strong net inflow in absolute terms, it does maintain a somewhat slower monthly net gain than earlier in the year when the net flow was running at an average of around 6,100. If the net migration inflow is indeed abating, it is doing so rather slowly. Meanwhile, tourism growth continues on its merry way, with arrival numbers in November up 8% on a year earlier. But from a current account perspective, this trend needs to be offset by accounting for stronger growth in NZ residents travelling overseas which were up 7% on a year ago.

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